Growing African economies through development of the services and investment ecosystem

Introduction

FinTech sectors, in terms of markets and policy concerns, operate across financial services, technology and data sectors. All three sectors are fast moving, are easily located and therefore easily exported. Reliance on a mature and innovation friendly services ecosystem, including legal, accounting and business services, can have a pull factor for establishment and location. This raises the prospect of investment and further evolution and maturity.

African economies, with. large underbanked and increasingly educated populations hold opportunity for high levels of growth. Digitalisation of the economy is high on the agenda. An uncompetitive banking sector currently faces challenges in reaching consumers and facilitating required levels of intermediation. Opportunity exists for innovative financial services to unlock and facilitate growth and connectivity with the global markets. Growing and unlocking the potential of African economies can be done through exporting and connecting key UK industry sectors.

FinTech – innovative and progressive retail consumer and wholesale capital markets

FinTech covers an increasingly broad range of activity. Retail consumer products and services dominate the FinTech agenda in the media due to the visibility of disruption and impact on the existing landscape of the offer to consumers. Open banking, for instance, continues to be a success in developed economies such as the UK and the EU and is also on the rise in low-income economies, notably in Asia. Brands are advertised and promoted in the general media. There are also significant benefits in terms of accelerating financial inclusion, be it through facilitating access to banking or by-passing it altogether to intervening for instance in the growing payments value chain. So-called Payments Initiation Service Providers, in EU legislative speak can be found to be active throughout several low-income economies.

Beyond banking and payments services, other traditional financial services that benefit in terms of access include online and P2P lending and insurance (insuretech). Point of sale lending in particular is gaining traction with consumers. Access to insurance has become an important consideration for the financial sector. Increased financial inclusion through the offer of basic services provides increased reach for the industry to offer coverage for climate change and health risk exposures for the poor. Initial relationships built on trust in one service or product offering is a gateway to offer more, thereby creating a cascade effect.

Developments in more novel services and products have also become important features of the FinTech story. Developments in digital assets and cryptocurrency, as an asset class and a facilitator of e-commerce, have dominated headlines and drawn an ever interested and growing client and userbase. Volatility associated with cryptoassets is not expected to slow the pace of central bank attention to developing central bank digital currencies. All market participants involved in e-commerce and payments should take note of and engage on developments in this and associated tokenisation and e-money policy. Importantly, developments around the e-wallets sector, particularly around e-KYC and cyber-security, traditional regulatory safety mechanisms, are expected to open up the economy to increasingly novel opportunities. Some extend beyond financial services. Block-chain based e-KYC and DLT based registration and transfer of title have the potential to reach markets beyond financial services. The flip side of this is the potential fats moving innovation in these areas have to exclude informal sectors and general public in low-income economies.

Retail financial markets are supported by wholesale markets, which in turn rely on complex financial plumbing. FinTech is playing a strong role in disruption through alternative offer, as well as by enhancing efficiencies in existing business models through evolving the system.

Capital markets will as a rule benefit from the liquidity generated by the increased reach of retail distribution, such as insurance premiums, access to savings products and financial activity generally. More directly, crowdfunding is becoming an important focus for both high and low-income economy investors and companies to connect. Platforms provide a higher degree of risk distribution and facilitate scale. SMEs in particular enjoy higher levels of investment in jurisdictions with a recognised crowdfunding regime. The regulatory environment is particularly important in developing this sector.

Financial plumbing, including clearing and settlement, facilitation of payments networks and systems, risk management and mitigation and credit assessments are among the areas where developed market experience can be quickly adopted in low-income economy infrastructure.

FinTech markets operate across financial, tech and data sectors. These markets are evolving together, and in some respects merging. Traditional trading venues such as equity and derivatives stock exchanges, for instance, today draw more revenue from data services than trading fees. This ecosystem is supported by a host of specialised service sectors. Facilitating innovative markets in retail financial services to increase choice and access, and capital markets and financial infrastructure to facilitate investment to the economy, will require working with the grain of progress in tech and data markets. Equally, while harnessing the opportunities from BigTech and digital markets, progress in e-commerce will require working with financial sector innovation. Seeking opportunities to develop and grow these markets should be done with a big picture perspective. It would be most effectively done by developing the broader ecosystem. This should be done with one eye on the increasing connections, and potential systemic implications.

Africa – needs present opportunities

Although African economies vary in terms of maturity of financial and FinTech sectors, the regional economy suffers from low levels of financial intermediation. Capital markets are illiquid and shallow, and this inhibits economic growth. Financial literacy levels are also low, and a high proportion of the population is underbanked. Despite the relatively high levels of activity in telco based mobile payments, financial inclusion generally is also low.

Low levels of investment, weak infrastructure, including internet coverage and electricity, as well as an uncompetitive banking landscape also present significant challenges to attracting and developing financial services and FinTech sectors. Low levels of financial intermediation and external investment deprive the region from being able to exploit the raw potential associated with disruptive technology. The success and role of telco based mobile payments in the economy, serving large and increasingly educated populations with high levels of access to hand-held devices, is indicative of the potential for innovation and reception of services and products in the region. The need case is clear.

Development of capital markets in African economies is important in facilitating growth in important real economy sectors, as well as protecting against high levels of volatility in the economy. Increased liquidity associated with higher levels of intermediation through banking and capital markets can channel higher levels of investment to where it is most needed, be it machinery, R&D, housing or other infrastructure. FinTech solutions in high income and mature markets can facilitate step change and even leapfrogging to global standards and opportunities. Significant needs from the perspective of low-income African economies can be met locally based on innovation. Innovative and efficient capital markets can attract more investment from across the region and from global markets.

As well as drawing on expertise in mature financial markets and FinTech sectors, successful development of retail and capital markets in African economies also rests on a strong legal and regulatory environment providing for consumer and investor protection. Progress in this area will attract participation in novel fund-raising approaches associated with crowdfunding for instance. Legal services, accounting standards, regulatory culture and approaches can be developed with a view to supporting existing sectors to grow and find investment through innovative tech-based regimes.

UK – a market leading and innovative service ecosystem

Traditional retail and capital markets benefit from innovation. The UK FinTech sector is one of the fastest growing aspects of the economy. The retail sector is varied. A mature and heterogeneous payments regime is based on a technology neutral approach from regulators. Established and incumbent market players and innovative disrupters exploit a mature retail investments and insurance market, which in turn offers choice to consumers and investors. A thriving capital markets sector enjoys high levels of investment in the latest innovation and tested against a mature consumer base and wholesale markets ecosystem.

Tech, including AI and machine learning, provide improved efficiencies in areas from consumer credit checks, retail and wholesale investment markets as well as wholesale clearing and settlement functions and almost instantaneous payments system. This fosters an eco-system that is growing and changing constantly, alongside a regulatory framework that is also nimble to change and evolves to accommodate development.

A fast growing and successful FinTech sector in London (and increasingly other parts of the UK) sits within a broader ecosystem, including traditional financial services and other important service sectors. Together they attract capital at scale and can thereby facilitate financial intermediation for not only the UK but also the global economy.

The so-called soft infrastructure of the City, the legal and accounting services, business advisory services and a regulatory regime sensitive to risk-based oversight all work to support fast paced innovation. The treatment of connected sectors, in particular digital and tech and data sectors, benefit from big picture thinking by regulators and policy makers.

Green accelerator

The Green and digital agendas are intrinsically connected. As FinTech facilitates more efficient and effective allocation of capital and investment, the Green Agenda and implementation over coming years will determine the target destination. Each is expected to have an accelerator effect on the other. Technological development facilitating green initiatives are sure to receive fuller backing through appropriate cost benefit analysis. Indeed, not all FinTech is without risks. Meanwhile, green initiatives and projects are likely to benefit from targeted and well-informed investment and capital allocation. The sector as a whole is set to benefit from increased clarity and transparency, as well as efficiencies associated with reduced latency.

FinTech sectors including crowd funding, those facilitated by DLT and AI, and importantly regulatory reporting and big data analytics, are the most likely to facilitate financial markets and investment and capital allocation the soonest. The prospect of DLT and AI combined with big data hold potentially seismic shifts in the approach to and ability of investors for real-time assessment of individual companies, sectors and indices. Tokenisation is also expected to bring a new dimension to carbon trading.

Certain known challenges associated with FinTech sectors may present particular characteristics in the green sphere. Issues associated with legal certainty and validity of smart contracts, DLT compatibility with data protection principles and requirements such as GDPR, as well as governance issues will prove important to resolve, particularly from a FDI perspective. More difficult to overcome without further technological development are challenges associated with the energy intensiveness of certain sectors, such as crypto-asset mining. This basic problem exists for all digital activity, and while in some circumstances may be net neutral and progressive in relative terms to current market practice, energy consumption levels are difficult to ignore. This holds potential implications for the prospects of central bank issued digital currencies, other stablecoins and utility tokens, and the prospects of issuances of tokenised green bonds.

Conclusion

Strengthening and growing FinTech and financial services markets in African economies will continue to present increasing opportunities for UK and international FinTech and financial services industries. Growing and connecting African economies and financial and FinTech sectors to regional and international markets holds inherent value. Facilitating such growth through exporting and connecting the UK FinTech sector should involve the broader services ecosystem that has benefitted and boosted the City of London.

African economies, local financial markets and consumers stand to benefit from accelerated development in traditional markets. Increased choice and higher levels of growth through new products and services stand to benefit the jobs and employment agenda, as well as development goals. Efficiencies in payments, growth in savings and risk exposure coverage for the poor, including health and climate risks, will benefit regional economies. With a fast-growing population, advantages associated with the green agenda stand to multiply positive externalities at an international level. Ultimately, by working with and enhancing African markets and facilitating hard and soft infrastructure development, the growth over time will be sustainable, stable and self-sufficient.

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